



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended	01/03/00	Bill No:	AB 284
Tax:	Property	Author:	Strom-Martin
Board Position:	Neutral, Point Out Problems	Related Bills:	

BILL SUMMARY:

This bill would specify that the absence of “actual physical occupation” does not preclude the determination of a possessory interest.

ANALYSIS:

Current Law:

Revenue and Taxation Code Section 107 provides that a possessory interest can be found when a person has “possession of, *claim to*, or the *right of possession* of” tax exempt governmentally owned real property. Property Tax Rule 20(a)(2) provides that “a *right* to the possession of real property, or a *claim to a right* to the possession of real property” may result in a possessory interest. Rule 20(c)(2) then defines the term “possession” as “actual physical occupation” of real property. Combining the two provisions of Rule 20, a taxable possessory interest may be found when a person has “a *right to* actual physical occupation of real property” or “a *claim to a right to* actual physical occupation of real property”. Thus, a person need not actually occupy the property; a right to occupy the property or a claim to a right to occupy the property is sufficient. Rule 20(c)(3) provides that a “right” or a “claim to a right” includes such things as a use permit or agreement that creates a legal interest in real property. Thus, a person who has an agreement creating a legal interest in real property may have a possessory interest even though the person does not “occupy” the property in the physical sense.

Proposed Law:

This bill would specify in statute that “the absence of actual physical occupation does not preclude the determination of a possessory interest.” Thus, a person who has an agreement that creates an interest in governmental-owned real property, which in every other aspect meets the tests necessary to find a taxable possessory interest (i.e., independence, durability, exclusivity, and private benefit), would not be excluded from such a finding based on the fact that the person does not physically “occupy” the property.

In General:

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In certain instances a property tax assessment may be levied when a person or entity uses publicly-owned real property that, with respect to its public owner, is either immune or exempt from property taxation. These uses are commonly referred to as "possessory interests" and are typically found when an individual or entity leases, rents, or uses government-owned real property.

Revenue and Taxation Code Section 107 defines a possessory interest to mean "possession of, claim to, or right to the possession of land or improvements that is independent, durable, and exclusive of rights held by others in the property, except when coupled with ownership of the land or improvements in the same person."

The Board of Equalization promulgated a regulation, "Property Tax Rule 20, Taxable Possessory Interests" effective May 6, 1998, to further define the term "possession" for property tax administrators. Property Tax 20, reads, in part:

(a) **POSSESSORY INTERESTS.** "Possessory interests" are interests in real property that exist as a result of:

(1) A possession of real property that is independent, durable, and exclusive of rights held by others in the real property, and that provides a private benefit to the possessor, except when coupled with ownership of a fee simple or life estate in the real property in the same person; or

(2) A right to the possession of real property, or a claim to a right to the possession of real property, that is independent, durable, and exclusive of rights held by others in the real property, and that provides a private benefit to the possessor, except when coupled with ownership of a fee simple or life estate in the real property in the same person; or

(3) Taxable improvements on tax-exempt land.

* * *

(c)(2) "Possession" of real property means actual physical occupation. "Possession" requires more than incidental benefit from the public property, but requires actual physical occupation of the property pursuant to rights not granted to the general public; thus, the use of property such as hallways, common areas, and access roads at airports, stadiums, convention centers, or public facilities by customers or employees of those who may lease other public property at the public facility of which they have exclusive use does not constitute "possession" of those hallways, common areas, or access roads by the lessee of the public property."

(3) A "right," or a "claim to a right," to the possession of real property means the right, or claim to a right, to actual physical occupation of real property. For purposes of this subdivision, a right, or a claim to a right, to the possession of real property may exist as a result of the possessor having or claiming to have: (I) a leasehold estate, an easement, a profit a prendre, or any other legal or equitable interest in real property of less than fee simple or life estate, regardless of how the interest may be identified in a deed, lease, or other document; or (ii) a use permit or agreement, such as a federal grazing permit, a permit to use a berth at a harbor, or

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a county use permit authorizing professional rafting outfitters to commercially operate on a river, that creates a legal or equitable interest in real property of less than fee simple or life estate. [Emphasis added.]

Background:

Each year for property tax purposes, the Board of Equalization determines the fair market value of each public utility's unitary property. Included in the unitary assessment of some public utilities is value attributable to possessory interests in governmental-owned hydroelectric projects that are owned by water agencies and irrigation districts. These governmental entities use the hydroelectric projects for their water supply while the public utilities have power purchase contracts to buy all of the electrical power produced from the water flow; which power is then sold. The hydroelectric projects are designed so that the flow of water and the generation of electricity can be remotely controlled.

Prior to 1984, the Board of Equalization did not assess public utilities for these types of interests. In 1984, the Members of the Board of Equalization directed Board staff to begin to assess these interests as possessory interests. At that time the assessments were contested on the basis that the utilities did not have "actual physical possession and occupancy" of the property. Evidentiary hearings were held, with the Board upholding the assessments.

Recently, appeals have been again filed on these possessory interests in the wake of the enactment of Property Tax Rule 20 which for the first time used the phrase "actual physical occupation" in defining the term "possession." Prior to Rule 20, neither case law nor statute used this phrase. The appeals were filed on the basis that the utilities do not have "actual physical occupation" as noted in Rule 20. However, the appeals were withdrawn prior to a hearing before the Board of Equalization and the issue has not been formally reconsidered by the Board for a determination.

COMMENTS:

1. **Sponsor and Purpose.** This bill is sponsored by the Sonoma County Board of Supervisors. According to the background information request provided to the Assembly Revenue and Taxation Committee on this bill, the author's office states: "Pacific Gas and Electric (PG&E) contends that because it does not actually physically occupy several hydro-electric sites, its use of the sites as power generators does not constitute a taxable possessory interest. This tax is paid to local governments for the right to use public land. Local governments believe that since the utility company is still receiving exactly the same benefits from the plants, they should still be responsible for paying the tax. If this tax is waived, counties stand to lose a significant source of revenue, potentially in the millions of dollars statewide. This bill clarifies the definition of a taxable possessory interest so that if a company is still receiving benefits from the property, they will still be responsible for the tax."

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2. **Public utilities who have power purchase contracts with water agencies and irrigation districts to buy electrical power produced from the flow of the water have been assessed for a possessory interest in the facilities pursuant to a 1984 Board of Equalization directive.** Prior to 1984, the Board's staff had opined that these contracts *did not* create a taxable possessory interest.
3. **In 1999, appeals were filed on the factual issue of whether the terms of these power purchase contracts created a possessory interest because they give the power companies a right to physical occupation or whether they were simply agreements to purchase power generated by a government-owned entity.** However, since the appeals on this issue were withdrawn, the current Members of the Board of Equalization have not had the opportunity to reexamine the issue of whether the contracts create a taxable possessory interest. Initially, the appeals filed by public utilities appeared to be based on the argument that unless a person actually physically occupies real property (for instance a building on the property manned with employees) a possessory interest does not exist. In the case at issue, the hydro-electric facilities are designed so that the flow of water and the generation of electricity can be controlled from computers located at a remote location. The specific language used in this measure ("[t]he absence of actual physical occupation does not preclude the determination of a possessory interest") is in response to the anticipated argument that operation of government-owned property from an off-site location fails to meet the definition of "possession," and thus a possessory interest assessment is improper.
4. **As currently drafted, this language may mislead and confuse some people into believing that any physical occupation of government-owned property results in a taxable possessory interest.** Property Tax Rule 20 defined "possession" to mean "actual physical occupation." Prior to the adoption of Rule 20, the phrase "actual physical occupation," was not found in regulatory, statutory or case law. A person may have "actual physical occupation" of government-owned real property yet lack one or more of the elements necessary to find a possessory interest (i.e., independence, durability, exclusivity, and private benefit). If any one of these elements is lacking, a possessory interest does not exist despite the fact that a person has actual physical occupation. While the language in this bill on its face makes a true statement, i.e., that a possessory interest may exist even though a person does not have actual physical occupation, it does not then follow with an equally true inverse statement, i.e., that a person who may have actual physical occupation not have a taxable possessory interest. Although the phrase "actual physical occupation" is a definition of "possession," the amendments refer to precluding a finding of a "possessory interest" rather than precluding a finding of "possession".
5. **With respect to the definition of "possession," the amendment appears to be intended to be declaratory of existing law.** Board staff's position is that *exercise* of the right to actual physical occupation is not a necessity in finding a possessory interest as Revenue and Taxation Code Section 107(a) defines a possessory interest to include a "claim to, or right to the possession of land or improvements." The actual

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physical occupation does not have to occur; having the *right* or *claim* is all that is required.

6. **Could this language result in the expansion of the concept of possessory interests?** It can be argued that this language could be used as a foundation to elevate a contractual “right to receive goods” obtained from government-owned property (such as water or timber) to a “right in real property” and therefore subject the receiver to a possessory interest even if there is no right or claim to actual physical possession.
7. **Suggested Technical Amendments.** The amendments in the bill substitute the phrase “possessory interest means both of the following:” for the existing phrase, “possessory interest means the following:”. Although this amendment appears to be intended for the purposes of a grammatical reconstruction of the section, it could be interpreted to be a substantive change in that the preexisting language defining a possessory interest is changed from “either” to “both”. The following technical amendment would restore the use of the word “either”:

§107 (a) “Possessory interests” means either ~~both~~ of the following:

COST ESTIMATE:

The Board would incur some minor absorbable costs in informing and advising county assessors, public and staff of the law changes and update Property Tax Rule 20 to reflect these changes.

REVENUE ESTIMATE:

Background, Methodology, and Assumptions

Currently, there are five hydroelectric facilities in which a public utility has been assessed for a possessory interest assessment. Those properties include the Merced Irrigation District, Yuba County Water Agency, Placer County Water Agency, Nevada Irrigation District, and the Oroville-Wyandotte Irrigation District. The five properties span across eight different counties. PG&E has power purchase contracts with each of these hydroelectric facilities. In July 1999, Pacific Gas and Electric Company (PG&E) appealed its 1999 Board-adopted unitary possessory interest assessments for the five hydroelectric facilities. The appeal was based on the contention that their contracts did not create a possessory interest because they do not have “actual physical occupation” of the hydroelectric facilities. Based on information received from the Board’s Valuation Division, the value of the assessments appealed totaled \$180 million dollars, which at the basic 1% tax rate results in \$1,800,000 of property tax revenue.

Revenue Summary

Since, this bill serves only to clarify existing law it has no revenue impact. The intent of the bill, however, is to protect the current revenue derived from these possessory interests in

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the event that future appeals on this matter are filed by PG&E with the Board of Equalization determining that these possessory interest assessments are not valid because of the absence of “actual physical occupation.” The statewide revenue currently derived from these assessments totals \$1,800,000 at the basic 1% tax rate.

Qualifying Remarks

The total revenue currently derived from these possessory interests on a *statewide* basis is \$1,800,000. However, because of the assessed value allocation process for unitary property (in which the single value determined by the Board must be allocated to all counties where the state assessee has property holdings), if these assessments were no longer made, then there would be winners and losers among the various counties. The 8 counties where the facilities are located would lose \$4,250,000 and 41¹ counties who receive a share of revenue from PG&E’s unitary property would gain \$2,450,000 (\$4,250,000 – \$2,450,000 = \$1,800,000). The eight counties where the facilities are located would lose more than the net \$1,800,000, because their allocated share of PG&E’s total unitary value would decrease.

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¹ There are nine California counties where PG&E does not have property: Del Norte, Imperial, Inyo, Los Angeles, Mono, Orange, Riverside, San Diego, and Ventura.

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